

FAIR HOUSING ACT (FHA)

OVERVIEW

The Fair Housing Act (FHA) is the short title of Title VIII of the Civil Rights Act of 1968, as amended (42 U.S.C. 3601 et seq). Congress amended the FHA in 1988 [Public Law 100-430] to:

- Establish an administrative enforcement mechanism under HUD
- Allow for increased penalties for violations of the FHA
- Include certain secondary mortgage market conduct
- Add two new protected categories to the FHA, i.e., handicap and familial status (having children under the age of 18)

The Department of Housing and Urban Development (HUD) issued comprehensive FHA regulations for the first time in 1989 (24 CFR Parts 100-121). The FHA and the implementing regulations are critically relevant to financial institutions involved in real estate-related transactions.

HUD has primary enforcement authority for compliance with the FHA. The FHA charges the FDIC, as a federal regulatory agency of financial institutions, with the responsibility of ensuring in an affirmative manner that FDIC-supervised institutions comply with the FHA to further the goal of providing for fair housing throughout the U.S. (Section 808(d)).

Examination Objective(s)

The objectives of the examination are to determine:

- Whether the financial institution is adhering to nondiscriminatory practices relative to real estate-related transactions
- Whether the financial institution's policies, procedures and internal controls are designed to assure nondiscriminatory practices relative to real estate-related transactions

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FHA The Fair Housing Act (FHA)

The FHA makes it unlawful for any lender to discriminate in its housing-related activities against any person because of:

- Race
- Color
- Religion
- National origin
- Sex
- Familial status
- Handicap

These factors are referred to throughout this section and the implementing regulations as "prohibited bases".

FHA AND IMPLEMENTING REGULATIONS

Some of the most important FHA provisions affecting financial institutions involved in real estate-related transactions include:

- Section 801

Section 801 states "it is the policy of the United States to provide, within constitutional limitations, for fair housing throughout the United States."

- Section 802

Section 802 defines a dwelling as "any building, structure, or portion thereof, which is occupied as, or designed or intended for occupancy as, a residence by one or more families and any vacant land which is offered for sale or lease for the construction or location thereon of any such building, structure or portion thereof." A family can be comprised of a single individual. Transactions include those for all types of dwellings, such as condominiums, cooperatives, time-sharing properties, and mobile homes.

- Section 804

Section 804, addresses sales, rentals, and related activities. Section 804 prohibits the following with respect to the sale or rental of housing if

based on race, color, religion, sex, handicap, familial status, or national origin:

- Refusing to sell or rent housing after a bona fide offer is made, or

FHA AND IMPLEMENTING REGULATIONS

(cont'd)

refusing to negotiate to sell or rent, or otherwise make unavailable or deny, a dwelling to any person

- Discriminating against any person with respect to terms, conditions, or privileges of sale or rental of a dwelling, or with respect to the provision of services or facilities in connection with the sale or rental
- Making any oral or written statement or advertisement with respect to a sale or rental of a dwelling that indicates any preference, limitation, or discrimination or an intention to make any such preference, limitation, or discrimination
- Representing to any person that any dwelling is not available for inspection, sale, or rental when such dwelling is available
- Inducing or attempting to induce for profit, any person to sell or rent any dwelling by representations regarding the entry or prospective entry into the neighborhood of a certain person or persons

It should be noted that Section 804 does not explicitly afford to handicapped persons and families with children all the same protections provided to others under the FHA. However, HUD believes that the legislative history of the FHA and the development of fair housing law after the protections of the law were extended in 1974 to prohibit discrimination because of sex support the position that persons with handicaps and families with children must be provided the same protections as other classes of persons. Accordingly, HUD's implementing regulations do afford the same protections to all protected classes.

Section 804 is particularly significant because it makes it unlawful not only to refuse to negotiate or complete a sale or rental, but also to "otherwise make unavailable or deny" a dwelling on a prohibited basis. The court has characterized this language as being "as broad as Congress could have made it" and as "catch-all phraseology which may not be easily discounted or de-emphasized." (United States v. City of Parma, 347 F. Supp. 730 (N.D. Ohio, 1974), a case dealing with the city's zoning practices.) Thus, Section 804 is not only applicable to an institution's lending practices, but also to an institution's managing and marketing of its owned residential real estate.

- Section 805

Section 805 applies to the financing, selling, brokering, and appraising of housing. Under Section 805 it is unlawful for a financial institution to discriminate against any person in making available, or in setting the terms and conditions of, a residential real estate-related transaction because of race, color, religion, sex, handicap, familial status or national origin.

**FHA AND
IMPLEMENTING**

The term "residential real estate-related transaction" is defined as any of the following:

**REGULATIONS
(cont'd)**

- The making or purchasing of loans or providing other financial assistance for purchasing, constructing, improving, repairing, or maintaining a dwelling
- The making or purchasing of loans or providing other financial assistance secured by residential real estate
- The selling, brokering, or appraising of residential real property

Additional guidance for interpretation of Section 805 can be found in 24 CFR 100.135 as it relates to appraisal practices and 24 CFR 100.125 as it relates to the purchase of loans. These are discussed below.

Appraisals

It is unlawful to use a property appraisal in connection with the financing of any dwelling when the person knows or reasonably should know that the appraisal improperly considers a prohibited basis. The word "improperly" is intended to make it clear that an appraisal may, for example, consider an adaptable physical environment (for example, wheel chair access) as a positive factor in estimating the value of residential real property. While a handicapped-based factor may be considered in this manner, it would not be proper or lawful to consider factors such as race, sex, or national origin in appraising residential real estate.

**Purchasing and
Marketing of
Loans, Debts, or
Securities**

It is unlawful to refuse to purchase loans, debts, or securities that support the purchase, construction, improvement, repair or maintenance of a dwelling, or that are secured by residential real estate, on a prohibited basis. Unlawful conduct includes, but is not limited to, purchasing loans that relate to, or that are secured by dwellings in certain communities or neighborhoods but not in others because of a prohibited basis concerning persons in such neighborhoods or communities. Further, it is unlawful for loans or other debts or securities related to or secured by dwellings, to be pooled or packaged differently because of a prohibited basis. Imposing or using different terms or conditions on the marketing or sale of securities issued on the basis of loans or other debts or securities that related to, or that are secured by, dwellings on a prohibited basis is also unlawful.

**FHA AND
IMPLEMENTING
REGULATIONS
(cont'd)**

The courts have held that, although Section 804 generally applies to sales and rentals and Section 805 to extensions of financial assistance in connection with housing, transactions involving sales or rentals and loans or other financial assistance in connection with housing are subject to both. The court said that the same conduct may be prohibited by either or both (*Laufman v. Oakley Building and Loan Company*, 408 F. Supp. 489 (S.D. Ohio, 1976)).

**Scope of Certain
FHA Violations**

Certain unlawful actions may constitute violations in more than one section of the FHA and its regulations. Consequently, a financial institution's practices in the area of housing finance should be examined in a general way to ensure that they do not "otherwise make unavailable or deny" housing, even though no specific act or practice may violate any explicitly named prohibition of the FHA.

**Allegations of
Discrimination
Under the FHA**

The FHA, in Sections 810, 812, 813, and 814, provide various options for a person who claims to have been discriminated against. A complaint may be filed with HUD which will investigate and attempt to resolve the grievance by means of conference, conciliation, and persuasion. Aggrieved persons also may sue anyone who allegedly discriminated against them, whether or not they file a complaint with HUD. Finally, the Attorney General of the United States may sue for an injunction against any pattern or practice of resistance to the full enjoyment of the civil rights granted by the FHA.

**UNLAWFUL
LENDING
PRACTICES
UNDER FHA**

Like the other civil rights statutes, the FHA was broadly written, and has been accorded "a sweep as broad as its language" in the courts. A wide variety of lending practices has been found illegal under the FHA, including some practices that are not specifically mentioned in the FHA itself but that have been determined to be illegal because they violate requirements and prohibitions that are implicit in its language. What follows are discussions of some prohibited practices, and where relevant, discussions of the cases in which courts have determined them to be prohibited.

**Redlining on a
Prohibited Basis**

Redlining on a racial basis has been held by the courts to be prohibited by the FHA (*Laufman v. Oakley Building and Loan Company*). Redlining is the practice of denying loans for housing in certain neighborhoods even though the individual applicant may be otherwise eligible for credit. The term "redlining" refers to the presumed practice in mortgage lending of drawing red lines around portions of a map to show disfavored neighborhoods.

**UNLAWFUL
LENDING
PRACTICES
UNDER FHA
(cont'd)**

"Redlining" is unlawful under the FHA, however, only when done on a prohibited basis. The terms "racial redlining" refers to the practice of basing loan, insurance, or investment criteria on the racial characteristics of the people who live in a particular neighborhood, presumably because of a perception of risk arising from the racial or social composition of the population or changes in this composition.

"Redlining" can be a rational response to a real risk. For instance, property located in a flood plain, in a slide area or close to a geologic fault may present a level of risk that would be unacceptable to a mortgage lender or insurer. Redlining practices are said to gain an impropriety, however, when the perceptions of risk upon which they are based are unrealistic, inaccurate or arbitrary, or when the boundaries of the affected area are overbroad so that the practices result in negative decisions being made with respect to whole neighborhoods that may

**Redlining on a
Prohibited Basis
(cont'd)**

contain sound properties and that might otherwise be stable and viable. Where institutions have excluded areas based on economic considerations such as those mentioned above, the burden is on the institution to substantiate that the exclusion is based solely on those considerations.

Racial redlining has been held to be unlawful by the courts. In addition, the major secondary market organizations that purchase home loans (Federal Home Loan Mortgage Corporation and Federal National Mortgage Association) have stipulated that the racial composition of areas must not be considered in appraisals for home loans submitted for purchase by these organizations.

This does not mean that a lending institution is expected to approve all housing loan applications or that it must make all loans on identical terms.

Denying loans, or granting loans on more stringent terms and conditions, however, must be justified based on economic factors such as:

- An applicant's income or credit history
- The condition, use, or design of the proposed security property (or of nearby properties that clearly affect the value of the proposed security property) provided such determinants are strictly economic or physical in nature
- The availability of neighborhood amenities or city services
- The need of the financial institution to hold a balanced real estate loan portfolio, with reasonable distribution of loans in various neighborhoods, types of property, and loan amounts

Each of the above factors must, however, be applied without regard to the race, color, religion, national origin, sex, handicap, familial or marital status of prospective borrowers or residents of the neighborhood.

**UNLAWFUL
LENDING
PRACTICES
UNDER FHA
(cont'd)**

**Making
Excessively Low
Appraisals**

Making excessively low appraisals, in relation to purchase price, based on prohibited considerations, is closely akin to redlining. This practice, which forces minority loan applicants to make larger downpayments, was held, in connection with a court-approved settlement, to violate FHA Sections 804 and 818 (formerly 817) in the case brought by the Justice Department against the American Institute of Real Estate Appraisers (U.S. v. American Institute of Real Estate Appraisers, 442 F. Supp. 1072 (N.D. Ill, 1977)). This decision's logic also applies to financial institutions that lend based on such appraisals.

**Arbitrary,
Subjective, Non-
reviewable Rental
Criteria**

The use of arbitrary, subjective, non-reviewable rental criteria leading to an otherwise unexplained racial (or sex, religious, etc.) imbalance in clientele was found to be illegal under Section 804 in one case (*U.S. v. Youritan Const. Co.* 370 F. Supp. 643 (N.D. Cal., 1973)). Here, the resident manager had instructed the rental agents to use differing procedures when approached by a black applicant than when approached by a white applicant. For example, white applicants were told that no credit check was necessary, whereas black applicants were told a lengthy one would be necessary. White applicants were told that there were vacancies when black applicants were told there were none. The court's rationale would clearly be applicable to lenders who also use such standards in their housing lending.

**Creation and
Exploitation of a
Racially Exclusive
Image**

Creation and exploitation of a racially exclusive image, even where there may be little concurrent evidence of a discriminatory policy put into practice against any given individual applicant, has been repeatedly found to be illegal in the employment context and with respect to the FHA (*U.S. v. Real Estate Development Corp.*, 347 F. Supp. 776 (N.D. Miss., 1972)). One indication of the existence of such an image, and possibly of its exploitation by management might be the absence, or clearly less than conspicuous display, of the required Equal Housing Lending poster in the lobby of each office.

Section 804(c) of the FHA makes it unlawful to make or print a statement or advertisement with respect to the sale or rental of a dwelling indicating any preference or limitation based on a prohibited characteristic. The court has applied this prohibition to newspaper advertisements soliciting tenants and home buyers who spoke certain languages (*Holmgren v. Little Village Community Reporter*, 342 F. Supp. 512 (N.D. Ill, 1971)).

Using advertising that targets applicants of a particular race, etc., is one way in which a housing lender might exploit an exclusive image. The use of only white people in advertisements in such a way as to suggest that only white applicants are sought, is an example of this type of advertising. Another is use of media that caters only to selected segments of the population, if such selectivity is not offset by other advertising efforts. Other examples of selective advertising practices that can lead to discriminatory results and may indicate a violation of the FHA are explicitly noted in 24 CFR 109.25.

**UNLAWFUL
LENDING
PRACTICES
UNDER FHA
(cont'd)**

**Creation and
Exploitation of a
Racially Exclusive**

Additionally, ECOA prohibits a creditor from discouraging applications for credit on a prohibited basis. The creation of an exclusive image that tends to discourage certain otherwise qualified applicants may be considered a violation of the ECOA with regard to discouraging applications on a prohibited basis. Other examples of discouraging applicants on a prohibited basis are refusing to return black applicants' telephone calls, or providing black applicants with insufficient information to complete an application, as well as outright denials. Read together, the FHA and ECOA produce a strong statutory prohibition against prescreening or discouraging applicants in any manner, beginning with the content of advertising, that may be construed to have a discriminatory impact. Consequently, a financial institution would be well advised to ensure that its advertising and marketing

Image (cont'd)

policies do not have the effect, even inadvertently, of prescreening applicants for credit on prohibited bases.

**Discriminatory
Acts That Have a
Negative Impact
on Non-minorities**

Discriminatory acts that have a negative impact on non-minorities, such as white persons, are illegal, and such persons have standing to sue, according to a Supreme Court decision (*Trafficante v. Metropolitan Life Insurance Company*, 409 US 205 (1972)). Two tenants of an apartment complex, one white and one black, were able to bring suit under the FHA for loss of the social and business advantages they suffered because of the owner's policy of discriminating against nonwhites. They also claimed that they were "stigmatized" by policies that made the complex in which they lived a "white ghetto".

Additionally, a white plaintiff who was refused a mortgage on standard terms because the property was in an "integrated" neighborhood was permitted to bring suit under FHA Sections 804 and 818 (formerly 817) (*Harrison v. Heinerorth Mtg. Co.*, 430 F. Supp. 893 (N.D. Ohio, 1977)).

**Excessively
Burdensome
Qualification
Standards**

The use of excessively burdensome qualification standards for the purpose, or with the effect, of denying housing to minority applicants, has been held by the court to be illegal under the FHA (*U.S. v. Youritan Const. Co.*, 370 F. Supp. 643 (N.D. Cal 1973)). Here, the rental agents emphasized the security deposit to black applicants, but not to whites, and required credit checks for black applicants, but not for whites.

**UNLAWFUL
LENDING
PRACTICES
UNDER FHA
(cont'd)**

**More Onerous
Interest Rates**

The imposition on minority loan applicants of more onerous interest rates, or other terms, conditions, or requirements, is explicitly prohibited under FHA Section 805. The phrase "terms or conditions" as used in the FHA is very broad, and will cover many types of discriminatory practices. The courts found it to be illegal in one case for a developer to follow a policy of selling lots in a subdivision only to persons having construction contracts with "approved" builders (*Williams v. Mathews Co.*, 499 F. 2d 819 (8th Cir., 1974)). All the "approved" builders were white and none of them would break the segregation barrier by building a house for a black family in a white subdivision.

**Differing
Standards or**

As a further development of the "terms or conditions" language of the FHA, Section 805, the courts have held the application of differing standards or procedures in administering foreclosures, late charges, penalties, or

Procedures

reinstatements, or other collection procedures is also unlawful (Harper v. Union Savings Assoc., P.H. Sec. 15,203 (N.D. Ohio, 1977)).

**Terms or
Availability of
Insurance**

Discrimination in the terms or availability of insurance is a subject with respect to which the FHA and the ECOA may seem to diverge somewhat. The ECOA does not prohibit a creditor who sells or participates in the sale of insurance from differentiating in the terms and availability of insurance on prohibited bases. Nor does it prohibit discrimination regarding the availability or terms of credit on the basis that insurance is unavailable, unless the insurance has been denied based on age. However, when dealing with housing credit the result may be different. The Department of Justice has taken the position that the FHA is violated when insurance required for housing credit is denied, or made more difficult to obtain, on a basis prohibited by the FHA.

This does not mean that a financial institution cannot require insurance, particularly casualty insurance, in connection with its mortgage loans. However, if the financial institution offers, or assists in obtaining, insurance, and the insurance is denied or made available on more onerous terms because of unlawful discrimination; or if the customer is adversely effected in the terms or availability of credit because insurance is unavailable, the financial institution has violated the FHA. If, on the other hand, the financial institution merely requires that the customer obtain insurance from an insurance company of the applicant's choice, and the insurance company approached by the customer discriminates unlawfully regarding the terms or availability of insurance, it seems that the institution would have no liability for the insurance company's action.

**UNLAWFUL
LENDING
PRACTICES
UNDER FHA
(cont'd)**

Racial Steering

Racial steering, or deliberately guiding potential purchasers toward or away from certain areas because of race, is illegal and violates Section 804.

The court said:

"Unlawful steering or channeling of a prospective buyer is the use of a word or phrase or action . . . which is intended to influence the choice of a prospective property buyer on a racial basis . . . Where choice influencing factors such as race are not eliminated, freedom of choice in the purchase of real estate becomes a fantasy . . . It is the freedom of choice in the purchaser which the Fair Housing Act protects. Accordingly, any action . . . which in any way impedes, delays, or discourages on a racial basis a prospective home buyer from purchasing housing is unlawful" (Zuch v. Hussey, 394 F. Supp. 1028 (E.D. Mich., 1975)).

**Other Possible
Discriminatory**

Other possible discriminatory lending practices might include:

- Racial notation or code on appraisal forms or loan forms (other than the
-

Lending Practices

information required by law to be retained for monitoring purposes)

- Use of scripts by initial interview personnel that are designed to discourage applications.
- The following are some situations that may be encountered that constitute sex discrimination:
 - Discounting or disregarding the income of a working spouse or single woman
 - Refusing to grant a loan, or granting a loan on different terms and conditions, because of sex
 - Requiring more or different information from a female applicant than from a male applicant
 - Subjecting a female applicant to a different or more extensive credit check than that usually required for male applicants
 - Refusing to include alimony or child support as income where there is evidence of a history of consistent prior payment and indication that payments are likely to continue
 - Basing any aspect of a lending decision on general presumptions about women (for example, women of childbearing age are poor risks)
 - Treating single working parents differently from married working parents
 - Requiring a cosigner for female applicants, but not for male applicants

UNLAWFUL LENDING PRACTICES UNDER FHA (cont'd)

Summary

A further elaboration of unlawful lending practices, with the focus primarily on race, is in the pamphlet "Home Mortgage Lending and Equal Treatment: A Guide for Financial Institutions," published by the Federal Financial Institutions Examination Council (FFIEC). This guide highlights some lending standards and practices that may adversely affect the ability of credit applicants, in obtaining home mortgages. Some less obvious forms of discrimination that may occur through the actions of lenders and ways for lenders to avoid such practices are discussed.

It should be emphasized that financial institutions are not expected to make unsound loans or render services on more favorable terms to applicants solely because of their status as member of a class protected by the FHA or ECOA. The statutes' intent is that loans cannot and should not be denied, or made more onerous, even partially, based on any applicant's status as a member of a protected category.

As the court stated: "Race is an impermissible factor in real estate transactions under both (the Fair Housing and the 1870 Civil Rights Acts) and cannot be brushed aside because it was neither the sole reason for discrimination nor the total factor of discrimination" (Williams v. Mathews Co).

PART 338 ¥
FAIR HOUSING

To provide the monitoring data needed to effectively analyze compliance with the fair lending provisions of the FHA, the FDIC adopted Part 338 in 1978. This regulation provides record keeping requirements with respect to applications for home loans. In 1991, Part 338 was revised to make the Fair Housing Log Sheet conform with the Loan Application Register (LAR) required by the Home Mortgage Disclosure Act (HMDA) and the Federal Reserve Board's Regulation C, its implementing regulation. Part 338 was further revised in 1997 to make the collection of information about a home loan applicant's race and other personal characteristics consistent with the Equal Credit Opportunity Act (ECOA) and Regulation B, the Federal Reserve Board's implementing regulation. This revision also served to notify certain insured state nonmember banks of their duty to maintain an LAR pursuant to Regulation C and to report the reasons for denial of any home loan application that would be reportable under Regulation C.

Particular attention is directed toward the definitions of certain types of loans for the purposes of Part 338's use of the LAR:

A **home loan** means any loan secured by and made for the purpose of purchasing or refinancing a dwelling.

A **home improvement loan** means any loan that is stated by the borrower, at the time of the loan application, to be for the purpose of repairing, rehabilitating, or remodeling a dwelling; and is classified by the financial institution as a home improvement loan.

These definitions conform to those contained in Revised Regulation C.

PART 338 ¥
FAIR HOUSING
(cont'd)

Recordkeeping
Requirements

Every financial institution that makes home purchase and refinance loans is required to request and retain the following initial data on each home purchase loan applicant (excluding applications received by telephone):

- Race/national origin
- Sex
- Marital status
- Age

(Section 338.7)

Disclosure

The institution shall inform the applicant(s) that the data regarding race/national origin, marital status, age, and sex is being requested by the Federal government for the purposes of monitoring compliance with the Federal statutes that prohibit discrimination on those bases. The institution shall also inform the applicant(s) that the institution is required to note the race/national origin and sex based on visual observation should the applicant(s) choose not to provide his/her race/national origin, marital status, age, and sex. (12 CFR 202.13(c))

Record Retention

The institution is required to retain the monitoring information requested from applicants for 25 months after the institution notifies an applicant of the action taken on an application (12 CFR 202.12). This requirement also applies to records of home purchase loans originated by the institution and subsequently sold.

FHA AND HMDA

Information maintained and collected under the Home Mortgage Disclosure Act (HMDA) should be reviewed to determine an institution's acceptance/rejection lending ratios as these may indicate possible differential treatment of applicants based on race, sex or marital status. HMDA data also can be very helpful in geographic-based analysis. Determining the percent of primarily minority, majority, and integrated census tracts within an institution's lending area and the percent of applications received, approved, denied and withdrawn can aid in discerning possible race-based redlining and/or prescreening. The HMDA-LAR also can be used to select applications with certain applicant characteristics for purposes of comparison of treatment of the lending institution.

Where institutions are not HMDA reporters, possible differential treatment indicators may be computed manually depending on the availability of records in the financial institution. This is done by computing the percentage of accepted, rejected, and withdrawn applications submitted by: whites, blacks,

FHA AND HMDA (cont'd)

Hispanics or other minorities, and females and males. These groups can be compared to other groups in terms of treatment and then compared to their representation in the composition of the community for purposes of possible prescreening or discouragement.

The Workpapers Appendix of this manual contains an "Applications Analysis Worksheet". This worksheet summarizes the "Mortgage Lending Decision Analysis (MLDA) Worksheet". This worksheet must be prepared and included in the institution's workpapers. Any apparent disparities resulting from analysis of the volume and group distribution of accepted, rejected, and withdrawn applications should be investigated.

FHA AND CRA PUBLIC EVALUATION

When a financial institution is subject to the performance tests and standards under Part 345, the examiner must write a paragraph within the performance evaluation about the institution's record of complying with the antidiscrimination laws using the following guidelines.

Record Compliance with Antidiscrimination Laws in the CRA Public Evaluation	
<i>When substantive violations are identified . . .</i>	
1.	When substantive violations involving illegal discrimination or

discouragement are identified by the FDIC or identified through self-assessment(s), the examiner should:

- State that substantive violations were found
- State whether they caused the CRA rating to be adjusted downward
- State why the rating was or was not adjusted

The examiner should:

- Identify law(s) and regulation(s) violated
- Identify extent of the violation(s) (for example, widespread, or limited to a particular state, office, division, or subsidiary)
- Characterize management's responsiveness in acting upon the violation(s)

2. Determine whether the institution has policies, procedures, training programs, internal assessment efforts, or other practices in place to prevent discriminatory or other illegal credit practices.

**FHA AND CRA
PUBLIC
EVALUATION
(cont'd)**

If no substantive violations were identified . . .

1. If no substantive violations were identified, state that no violations of the substantive provisions of the antidiscrimination laws and regulations were identified.

Even if discrimination has not been identified, comments related to the institution's fair lending policies, procedures, training programs, and internal assessment efforts may still be appropriate. If applicable, technical violations cited in the Compliance Report of Examination should be presented in general terms.

If a financial institution is not yet subject to the revised Part 345 regulation, CRA Performance Category IV and Assessment Factor F address evidence of prohibited basis discrimination and other illegal credit practices.

The results of the fair lending examination efforts will involve possible public disclosure, whether or not there are findings of violations. The CRA Public Evaluation also should include a reference to substantive fair housing violations cited in the examination report.

**EXAMINATION
PROCEDURES**

NOTE: Examiners should note any statements that appear to be or will have the effect of being discriminatory against any of the protected classes. A review of accepted, denied and withdrawn applications, discussions with lending

personnel and an evaluation of the loan policy should be used in the analysis. The reasons for denial and any exceptions made (especially to underwriting and appraisal policies and practices) regarding approved applications are particularly significant to the analysis.

There are four basic parts to the FHA examination process:

- Collecting and evaluating information
- Selection and analysis of the loan sample or samples
- Completion of the examiner check list and worksheets
- Determining conclusions and findings

Besides the FHA examination procedures that follow, examiners may refer to the procedures in this manual regarding the investigation of FHA complaints alleging discrimination for additional analytical guidance.

**EXAMINATION
PROCEDURES
(cont'd)**

**Collecting and
Evaluating
Information**

Collect and Evaluate Information

**EXAMINATION
PROCEDURES
(cont'd)**

1. In addition to all real estate-related policies and procedures, including all forms used for real estate-related transactions, the following items should be collected; if not already collected through other segments of the compliance examination:
 - Previous reports of examination, both compliance and safety and soundness
 - The CRA Statement, if applicable, the CRA Public Evaluation, the contents of the CRA public file; and the Compliance Information Request
 - For HMDA reporting institutions, the HMDA LAR, the HMDA Disclosure Statement for the previous two years, and for all institutions located within an MSA, the HMDA MSA Aggregation Report for the previous two years
 - Any correspondence, including complaints and protests and pending litigation, directed to the institution regarding allegations of possible housing discrimination and the financial institution's response(s)
 - The minutes of meetings of the board of directors/trustees, shareholders, and relevant committees within the institution's organizational structure relevant to housing-related transactions
 - Internal reports, audits (internal and external), evaluations (including credit ascertainment findings), and plans (including marketing plans), and the geographic distribution analysis containing housing-related information
 - Any advertising copy used since the date of the previous examination concerning real estate-related transactions
 - Real estate-related loan transaction policies including underwriting standards, terms, and conditions, appraisal standards and practices, and collection and foreclosure policies
 - Copies of any instructions and advisements to the institution's employees with real estate loan processing or underwriting or appraising responsibilities; similarly, any instructions and advisements to real estate brokers, builders, investors, mortgage originators, or private mortgage insurance companies
 - Copies of all manuals, instructions, and other materials used to train loan officers, loan officer trainees, or loan processing personnel engaged in real estate-related transactions
 - A copy of the following forms used since the prior FHA review:
 - Loan application, pre-application, "in-house" application for all types of loans offered
 - All work sheets, pre-qualification sheets or similar forms
 - All property appraisal forms
 - All loan processing checklists

**Collecting and
Evaluating
Information
(cont'd)**

- Disclosure statements
- Good faith estimate forms
- Uniform settlement statement forms
- Fair Credit Billing notices
- Internal credit review sheets or scoring systems
- Loan guarantee forms
- Security agreements and notes
- Borrower's financial statement
- Standard rejection letters
- Other notifications
- ECOA notices
- Dealer agreements
- Right to Rescind forms

- A copy of mailing lists, particularly real estate-related businesses, lists of parties used, including PMI companies, appraisers, title insurers, title attorneys, etc.

2. Additionally, examiners should obtain demographic and community contact information.

This information can be provided by the regional FDIC Community Affairs Officer(s) or by other governmental agencies and includes, but is not limited to, community profile(s); and the housing and economic development elements of the local general plan. For untraced areas, the U.S. Census County Data Book can be consulted. (This source provides community housing needs information including the number of housing units, standard and substandard housing, vacancy rates, owner occupancy levels, age of structures, the number of small farms and small businesses).

3. Interview employees responsible for responding to loan inquiries and employees who take applications to determine what policies and procedures are followed in practice.

Determine:

- How a real estate-related application is made and processed, and where applications are obtained and submitted
- If the institution evaluates creditworthiness or eligibility based on information obtained from telephone conversations, particularly from questions concerning property location
- Whether the institution uses outside persons to refer or advise applicants and if so, determine their training and instructions
- Who fills out the application, an employee or the applicant

**EXAMINATION
PROCEDURES
(cont'd)**

**Collecting and
Evaluating
Information
(cont'd)**

- Whether there is anyone authorized to review the applicant's financial data or property characteristics to determine eligibility before the application is formally submitted
- If so, determine how it is done, who is so authorized, and if any record is kept of applications not ultimately submitted, and whether the practice occurs even though it is not formally authorized.

4. Review all written loan policies, procedures, training manuals and instructions, guidelines, etc., regarding real estate-related transactions concerning the institution.

5. Interview lending personnel to determine the criteria for credit decisions.
- The interview should be structured to determine the person's familiarity with the financial institution's established credit policy and prohibitions imposed by the FHA and ECOA regarding real estate-related transactions. Determine:
- How (when the verified information on the application and appraisal supports the loan) it is decided whether to make the loan and who makes that decision
 - When exceptions are made for loan applicants, and by whom, relative to the institution's lending policies and determine the standards, if any, for the making of these exceptions
 - That records are kept of these decisions and the reasons for these decisions

6. Where policies and practices are determined to be unwritten or to differ from written policies, verify that these coincide with relevant fair housing and fair credit laws, regulations, and rules, i.e., are nondiscriminatory in use and in effect, particularly concerning any prescreening practices.
- Information from outside contacts may be used in determining the existence of any possible unlawful prescreening practices. Examiners should review community contact forms completed by the FDIC as well as the other federal financial institution regulators. Determine if the institution is perceived as a nondiscriminatory lender with respect to any prohibited bases.

**EXAMINATION
PROCEDURES
(cont'd)**

**Collecting and
Evaluating
Information
(cont'd)**

7. Review all complaints and protests received by the institution and the FDIC since the previous examination for comments concerning possible real estate-related transaction discrimination. Identify any outstanding problem areas and investigate further as necessary.

8. Using the HMDA-LAR, the HMDA Disclosure Statement and the HMDA Aggregate Report, note the apparent demand by census tract for home loans, including home purchase, home improvement, refinancing, and multi-family financing.

Compare the institution's demand to that of the demand in the Metropolitan Statistical Area (MSA) through the HMDA Aggregate Report, especially in any minority census tracts within the institution's lending area.

Although 50% minority population is frequently used to identify minority census tracts, examiners may want to review different levels of minority population, possibly as low as 10%. If HMDA data is not available, further analyses based on alternative data sources from the city or county planning office could be undertaken.

9. If the institution's loan demand is weak or near non-existent in minority census tracts relative to the MSA pattern for the same census tracts or there is an inordinately high level of withdrawn applications by any group of applicants, outside contact interviews can be used to establish whether the community perceives the institution as prescreening and if so, how.

Establish whether those interviewed perceive the institution as welcoming the applications of members of protected classes and if the institution is perceived to be lending in all sectors of the community.

Sampling

Loan file analysis is central to FHA unlawful discrimination detection. The actual treatment of loan applicants is the most important point. Because of this, **it is always necessary to inspect and compare loans files** for both accepted and rejected applicants, by prohibited bases category.

EXAMINATION PROCEDURES (cont'd)

Sampling (cont'd)

Conduct Comparative Analysis via Sampling

**EXAMINATION
PROCEDURES
(cont'd)**

1. The examiner should determine:

- The institution's real estate-related loans categories
- The articulated and actual policies
- The credit decision-making process

Then, select a sample of loans for review for compliance with the FHA.

NOTE: Where there are several branches or decision centers, the location of the branches and decision centers should be considered since the location may affect the type of applicant likely to be attracted to that branch.

For example, if decisions are made at the branch level, a branch in an integrated area should be paired with a branch in a predominantly white area (assuming comparable income levels) to assure an adequate basis for comparison of loan files.

Sampling Guidelines

The sample(s) drawn should be from applications since the date of the previous examination. The size of the sample will vary depending on the size of the institution, volume of loans, and the number of offices. If a lender has an insufficient mortgage volume from which to draw a valid sample, the period covered by the sample should be expanded.

Types of Sampling

Judgmental sampling is normally more efficient and effective than either statistical or random sampling in uncovering whatever types of discriminatory practices may exist in an institution's real estate-related practices. Consequently, it is contemplated that judgmental sampling will be used to the maximum extent possible, particularly in selecting rejected and withdrawn application files.

2. Determine the control group and the target group.

To do comparative analysis, the examiner must first determine who the control group is and who the target group is. For the control group, the population will include only approved applications. For the target group, the population will usually include only rejected applications.

However, approved applications and withdrawn applications from members of the target group also can be included as these may bear evidence of disparate treatment. For example, loans are approved to members of protected groups but on more onerous terms or applicants from protected groups are encouraged to withdraw applications.

3. Decide which prohibited bases category(ies) to use as the target group(s).

It is not necessary, in every examination, to test for all prohibited bases nor is it necessary to sample every real estate-related loan product. This determination can be made based on several factors including, but not limited to a review of:

Sampling (cont'd)

- Community demographics
- HMDA data
- Complaints and protests concerning the institution
- Previous examination reports
- Discussions with institution management and members of the community

In essence, the examiner should form a "hypothesis" regarding which prohibited basis group might be discriminated against and in which loan product. One determination of loan product might be the institution's most popular product in the community.

The prohibited basis group should be comprised of applicants who possess the prohibited basis characteristic selected by the examiner to form the sample for comparison to the control group.

4. Select the target group(s) sample.

Unless the total number of rejected and withdrawn application files is unusually large, all such files should be reviewed in selecting the target group(s) sample. All rejected and withdrawn applicants of the targeted protected group(s) should be presented on a sample spreadsheet, such as the ones contained in the Standardized Workpapers Appendix of this manual.

Once the target group sample is decided, the examiner can decide the size of the control group sample. Generally, the control group sample should be at least as large as the target group sample(s) but may need to be significantly larger (such as, four times the size) to ensure that there is adequate basis for comparison.

5. Determine the control group.

The control group should be comprised of a sample of applicants determined by the examiner to seem least likely to involve prohibited basis discrimination. This group will usually be white males or white couples but may vary depending on local situations.

The control group can be selected through judgmental sampling or through random sampling. Additional guidance concerning use of random sampling can be found in the Sampling Appendix of this manual.

**EXAMINATION
PROCEDURES
(cont'd)**

Sampling (cont'd)

Additional Considerations

1. For HMDA reporting institutions, the sample(s) can be selected from the entries on the institution's LAR. These entries should be compared to the relevant source documentation to determine that the information on the LAR is accurate and complete.

2. The sample selected should always be placed on a spreadsheet.

The Workpapers Appendix of this manual contains a "Mortgage Lending Decision Analysis (MLDA) Worksheet". This spreadsheet must be used. Use of a sample spreadsheet will help to determine that the reasons for an applicant's denial are consistent with the institution's lending policies and practices and that policies and practices are consistently applied without regard to any prohibited bases.

Comparative Analysis

1. Applicant profiles should be compared for equal treatment.

Examiners should determine policy exceptions regarding each item on the sample spreadsheet, also minimum and maximum mortgage loan amounts and any other analytical ratios used by the institution.

Also determination should be made of articulated policy standards, actual practices and exceptions made regarding:

- Nature and length of employment
- Credit history
- Property underwriting and appraisal standards
- Any other relevant policy used by the lender

Examiners should indicate whether there is any pattern of exceptions that have caused the exceptions to become the standard policy and evaluate the likely effect of this practice on protected groups.

2. The control group should be compared with the prohibited basis(es) group(s) to establish equal or different treatment in terms and conditions, for example:

- Length of the amortization periods
- Interest rates
- Special fees
- Higher fees on smaller loans

Each key ratio should be compared (minorities and non-minorities) to discern individual differences in treatment and possible patterns.

**EXAMINATION
PROCEDURES
(cont'd)**

Sampling (cont'd)

The application of differential treatment to specific geographic areas also should be reviewed.

In comparing control group applicants to target group applicants it is not necessary for all the applicant characteristics to be similar. Rather, the examiner should look for similar "flaws" in characteristics.

Example of Inconsistently Applied Standards

For example, if applicants with a handicap appear to be denied based on debt to income ratios being too high, examiners should look for non-prohibited bases applicants that were approved with similar debt-to-income ratios.

Other inconsistencies might include:

- Nonminority applicants with identical debt service ratios are offered loans while a minority applicant is rejected
- An applicant from a minority neighborhood or with a handicap is offered a shorter mortgage length term than other applicants
- Interest rate inconsistencies that are not based on valid lending criteria
- Lower loan to value ratios applied to loan applicants from minority neighborhoods

Each file where an inconsistency is present should be reviewed for not only possible problems by the institution in applying its lending standards but also for any practices that may have a discriminatory effect on minorities, women, or other protected groups.

3. When an examiner sees the same type of problem cited as a reason for rejection, certain questions might arise causing the examiner to do a rereading of the lending policy or to reinterview a particular loan officer.

For example, if "insufficient income" is cited often, particularly with respect to members of prohibited bases groups applicants, the examiner must ask what the institution's definition of income is, whether all of an applicant's income is considered, whether the loan policies are restrictive, or where practices are more restrictive in defining income.

Refer to the items outlined in the FFIEC's "Home Mortgage Lending and Equal Treatment" pamphlet. These should be considered regarding each institution examined for compliance with the FHA.

**EXAMINATION
PROCEDURES
(cont'd)**

Sampling (cont'd)

<p>4. Examiners should determine if there is a possible pattern of "underappraisals" for members of prohibited bases groups.</p> <p>The MLDA worksheet has a category for "Loan-to-Selling Price Ratio." It should also be determined if the loan-to-price ratio is consistently less than the loan-to-value ratios for members of prohibited bases groups or for properties in certain areas of the institution's lending areas. The determination of possible underappraisals, which may be a problem for protected groups, can be made from these ratios.</p>
<p>5. Any exceptions found in the sample review process should be discussed with the institution's management to establish any additional information that may have a bearing on the individual file decision.</p> <p>If no reasonable explanation for the inconsistencies can be determined, then a violation, based on a preponderance of the evidence, should be cited.</p> <p><i>NOTE: Where denials or more restrictive terms correlate with census tract or neighborhood, then unlawful redlining may be a possibility and should be examined further.</i></p>
<p>6. In addition to the loan sample, examiners also should review foreclosure files, collection files, and institution owned real estate files.</p> <p>A sample of these may be reviewed if there is a large number of foreclosures, collections or institution owned real estate.</p>

Conclusions

Examination Conclusions
<p>1. Review the results of the FHA examination and summarize your conclusions about the institution's policies, procedures, and practices regarding FHA compliance focusing on:</p> <ul style="list-style-type: none"> • Material policy deficiencies • Material internal control weaknesses • Violations of laws, rulings, and regulations
<p>2. The examiner should document the factors used to select the sample(s), such as, the control group, the prohibited basis group, and the number of files reviewed.</p>

**EXAMINATION
PROCEDURES
(cont'd)**

Sampling (cont'd)

3. The examiner should include a comment on Page A of the Report of Examination (ROE) discussing the Fair Lending sampling procedures performed during the examination.

The comment should include:

- The examiner's hypothesis
- The identity of target and control groups
- The number of loan files reviewed
- The conclusion based on the procedures performed

Refer to the Bank of Anytown Report section of this manual for an example.

4. The examiner should prepare a memorandum for future compliance examinations and investigations detailing any information that might aid in understanding any significant or on-going problems found in the area of unlawful discriminatory treatment or impacts.

- The memorandum should be sent with the examination report to the Regional office for inclusion in the institution file
- Relevant comments should also be included on Page A of the Report of Examination (ROE)

5. Where problems are found, determine if areas of noncompliance are subject to the Policy Statement for the Enforcement of the Equal Credit Opportunity Act and/or the Fair Housing Acts.

The following six elements should be known for each violation:

- Description (summary of regulatory section and the six digit violation code)
- Discovery (violation found by examiner or institution)
- Frequency
- Primary Cause
- Intensity
- Disposition

Refer to the Instructions for Compliance ROE, Part VII, Section C, for details.

6. Substantive FHA issues should be reviewed with the Regional Office prior to discussions with the institution's management as supervisory action may be warranted.

**EXAMINATION
PROCEDURES
(cont'd)**

Sampling (cont'd)

Refer to the "Guidelines for Referring Violations of the Anti-Discrimination Provisions of the Equal Credit Opportunity and Fair Housing Acts to the Department of Justice or Notifying the Department of Housing and Urban Development of Violations of the Fair Housing Act" Memorandum to Regional Directors, transmittal # DCA-003, dated 1/23/97.

Examination Conclusions

7. Following the review with the Regional Office, the institution's management should be advised of all violations of law, rulings, regulations or significant internal control deficiencies, emphasizing their causes.

Discussions with management should also include recommended corrective action for deficiencies cited and obtaining management's commitment to specific actions for correcting deficiencies.

**WORKPAPER
STANDARDS**

Appropriate workpapers must be completed when reviewing compliance with Fair Housing. Refer to Standardized Workpapers, Appendix K, in this manual.



**FDIC LAW,
REGULATIONS,
& RELATED
ACTS**

Applicable Rules

Consumer Protection Act, Title VII - Equal Credit Opportunity, Volume 2, Page 6610
Equal Credit Opportunity Act, Volume 2, Page 6610
Fair Housing Regulations, Volume 3, Page 9633
Federal Reserve Board's Regulation B, Volume 2, Page 7209
Federal Reserve Board's Regulation B Official Staff Interpretations, Volume 2, Page 7241
Home Mortgage Disclosure Act, Volume 3, Page 8687
Part 345 –Community Reinvestment Act, Volume 2, Page 2781
Part 338 – Fair Housing, Volume 1, Page 2647
Regulation C – Home Mortgage Disclosure, Volume 3, Page 7553

**Advisory
Opinions**

Equal Credit Opportunity Act: Regulation B, Letter #89-44, Volume 1, Page 4420
Questions Concerning FDIC Enforcement of the Equal Credit Opportunity Act, Letter #87-39, Volume 2, Page 4279



**FDIC LAW,
REGULATIONS,
& RELATED
ACTS (cont'd)**

**Statements of
Policy**

FFIEC on Behalf of its Constituent Agencies – Joint Notice of Policy Statement on Discrimination, Volume 2, Page 5065

Equal Credit Opportunity and Fair Housing Acts Enforcement Policy Statement, Volume 2, Page 5221

Policy Statement on Discrimination in Lending, Volume 2, Page 5397

**DCA
MEMORANDA**

Guidelines for Referring Violations of the Anti-Discrimination Provisions of the Equal Credit Opportunity and Fair Housing Acts to the Department of Justice or Notifying the Department of Housing and Urban Development of Violations of the Fair Housing Act, Transmittal #DCA-003, dated 1/23/97

**FINANCIAL
INSTITUTION
LETTERS (FIL)**

Federal Reserve Seeks Comment on Proposed Revisions to Regulation B, Letter #73-97, dated 7/22/97

FDIC Finalizes Fair Housing Regulation (Part 338 of the FDIC's Rules and Regulations), Letter #67-97, dated 7/14/97

Proposed Revisions to the Equal Credit Opportunity Act and the Fair Housing Act Regarding Self-Testing of Lending Transactions, Letter #10-97, dated 2/14/97

Equal Credit Opportunity: Appraisals and Enforcement, Letter #12-94, dated 2/28/94

Interagency Policy Statement on Discrimination in Lending, Letter #29-94, dated 4/29/94

Pamphlet on Home Mortgage Lending and Equal Treatment, Letter #19-92, dated 3/16/92

Revisions to Guidance on Fair Housing Rules (Part 338), Letter #23-92, dated 3/20/92

Side by Side, A Guide to Fair Lending, Letter #47-94, dated 7/7/94



OTHER	FFIEC Community Reinvestment Act Examination Procedures and Performance Evaluations, "Red Book"
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